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NFAC No. 2181-79

THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

27 April 1979

National Intelligence Officers

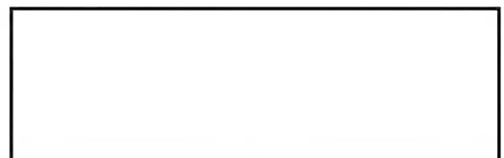
X1 MEMORANDUM FOR: Deputy Director, National Foreign
Assessment
FROM: [REDACTED]
National Intelligence Officer for China
SUBJECT: PRC Meeting on US-China Economic
Relations, 30 April, at 0930 hours

1. Action Requested: Review attached materials on issues to be discussed at the PRC meeting, which deal with some of the subjects to be addressed by Secretary Kreps during her trip to China.

2. Background: Secretary Kreps will be visiting China May 7-17 as part of our program to normalize US-China economic relations. The major issues in this regard were reviewed at the 13 March PRC meeting (see Summary of Conclusions of this meeting at Tab B), in which it was noted that Secretary Kreps might:



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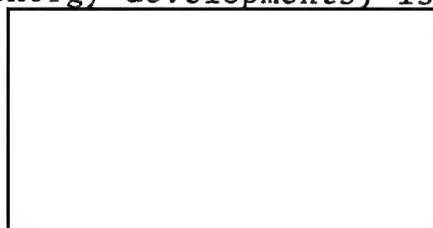


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5. There is no specific intelligence input, but in the event the subject arises a selection of NID items on China's revision of its economic priorities and related questions (foreign exchange situation and energy developments) is at Tab C.



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Attachment:

- A - Treasury Memo
- B - Summary of Conclusions
- C - NID Items

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CHINA: PROSPECTS FOR RAISING COAL OUTPUT (U)

Chinese plans to double coal output to more than 1 billion tons by 1987 are clearly beyond the industry's capabilities. If China does not move rapidly on signing foreign contracts for coal plants, equipment, and technology, output may not even meet what we expect to be scaled down plans for industry. In these circumstances oil would have to be substituted for coal in boilers, cutting down on potential foreign exchange earnings from oil exports. Such substitution would also reduce the oil available to the essential transport and petrochemical industries. (U)

Given its importance, coal will remain a priority industry as Beijing wrestles with revising its overambitious plans for economic development. It probably will be a leading beneficiary of Beijing's new willingness to import machinery on credit and to accept foreign involvement in modernization projects. But foreign help and imports will not erase 20 years of deferred development. (U)

Background

The People's Republic of China currently ranks third behind the United States and the Soviet Union among the leading world coal producers; Chinese reserves of at least 1.5 trillion tons also stand third, behind Soviet and US reserves. Coal supplies about two-thirds of China's primary energy requirements each year. Exports—primarily to North Korea and Japan—amount to approximately 3 million tons annually or less than 1 percent of production. The PRC imports about 2 million tons of coal, primarily anthracite. (U)

China's coal industry maintained a 7-percent average annual rate of growth in output during 1966-77. Production in 1978 is estimated at 600 million tons, about 10

China: Estimated Raw Coal Production

				Million Tons	
1949.....	32.4	1960.....	280.0	1970.....	327.4
1950.....	42.9	1961.....	170.0	1971.....	353.6
1951.....	53.1	1962.....	185.0	1972.....	376.5
1952.....	66.5	1963.....	200.0	1973.....	398.1
1953.....	69.7	1964.....	215.0	1974.....	410.6
1954.....	83.7	1965.....	232.2	1975.....	479.6
1955.....	98.3	1966.....	271.4	1976.....	488.0
1956.....	110.4	1967.....	190.0	1977.....	546.6
1957.....	130.7	1968.....	235.8	1978 ¹	600
1958.....	230.0	1969.....	281.6	1987 ²	1,000 +
1959.....	300.0				

¹ Preliminary.

² Planned.

Unclassified

percent higher than in 1977 and more than two and one-half times the 1965 level. These gains were led by the 11-percent annual growth in production from small mines, which provided more than 33 percent of total coal production in 1977. Output from major coal mining operations—each producing at about 10 million tons or more annually—has grown at more than 9 percent per year in the 1970s. (U)

Despite these gains, new investment in the coal sector was relatively small during the 1960s and early 1970s. As a result, mechanization lagged at large mines even though imported foreign equipment and domestically produced copies of foreign equipment were ticketed for these favored mines. The lack of large-scale investment in the coal industry also meant that maintenance was deferred, and the opening of large new mines necessary for long-term growth was postponed. (U)

Ambitious Plans

Early in 1978, Coal Minister Xiao Han (Hsiao Han) announced that coal production would double by 1987, reaching 1 million tons annually. This ambitious target was viewed as consistent with the growing energy requirements of the 10-year economic plan (1976-85) as well as China's decision to halt the substitution of oil for coal to save oil for export. To meet the target, annual increases in coal output would have to average 50 million tons yearly compared with 30 million tons a year during the early 1970s. This, in turn, would require massive investment in modernization, and more intensive use of existing capacity. (U)

In his address to the Fifth National People's Congress in February 1978, Chairman Hua Guofeng (Hua-Kuo feng) included eight new coal bases* in the list of capital projects to be completed by 1985. The list probably includes expansions or amalgamations of some existing coal complexes. On balance, we feel that China has been counting on adding about 100 million tons of capacity from new coal bases by 1985. Increased production from existing facilities would provide most of the remaining planned increase in output by 1985. (U)

The coal industry faces formidable problems in meeting these output targets. Shortages of modern mining equipment and trained personnel will be particularly serious obstacles. Domestic manufacturers of mining equipment in the past gave priority to other extractive industries where demand is expected to continue to expand under the economic modernization program. Moreover, because equipment shortages limited the number of mines with fully mechanized coal face equipment, few miners have experience in operating modern mining equipment and few managers have experience in modern extraction techniques. (U)

* The Chinese use *coal base* as an administrative term to refer to a complex of facilities associated with coal mining. (U)

Beyond this, most of the easy and inexpensive opportunities to expand capacity have probably been exhausted. One reason is that the Chinese have concentrated on low-cost expansion of existing mines over the last 10 years. Indeed, the need for a major new investment program has been clear for a number of years and great effort would appear needed just to maintain the 30-million-ton annual average increments of recent years. (U)

Need for Outside Help

Foreign equipment and services and the development of a surface mining program are the key themes in China's attempt to move the coal industry in a new direction. Over the short term, foreign coal mining equipment can help to improve extraction rates, while foreign firms tackle the problem of opening up new coal fields. China also appears interested in buying consultation services for refurbishing existing coal mines and in expanding its capacity to build mining machinery. (U)

China has held extensive discussions with foreign coal equipment suppliers and coal mine developers involving potential contracts totaling several billions of dollars. So far only a few contracts have been signed, however, primarily for mechanized equipment to increase production at China's existing mines and for design contracts for new mines. Although negotiations for one large mine have been going at least a year, China has not committed itself on longer term new capacity contracts. (U)

Prospects

China's sluggishness in signing foreign contracts and the sheer magnitude of the task will prevent reaching the 1987 goal. Coal supplies should still be sufficient to meet domestic needs, if, as expected, China scales down the original plans for heavy industry. The original 1985 target of 60 million tons of steel production alone would have required about 100 million tons more coal than in 1977. But, Chinese spokesmen have already indicated that the steel target is being cut back. Reduced heavy industry targets would also lessen the pressure on expanding coal-fired electric power capacity, the backbone of China's electric power program. (U)

China cannot wait too long to sign foreign contracts for the coal industry because of the time it will take to implement new plans to increase coal capacity. The PRC can ill afford coal constraints at the same time that oil production may be leveling off at existing fields. Coal shortages would cause substitution of limited oil supplies for coal in domestic boilers and cut into China's hopes for building up an oil export market. Shortages would also disrupt China's plans to limit domestic oil consumption to the high-priority petrochemical and transport industries. (U) (Unclassified)

China Reports Poor First Quarter in Industry (U)

Beijing this week reported a strikingly low first-quarter increase of 5.6 percent in industrial output compared with first quarter 1978. Although the point was not made in the announcement, the figure shows that industrial production so far this year has been no higher than average quarterly output in 1978. The leadership has recently conceded that the economy is suffering from major sectoral imbalances and has been sponsoring wide-ranging reforms in industrial organization and a reordering of investment priorities both within industry and agriculture. In addition, officials are now saying that two to three more years of readjustment may be required for the economy to recover from the decade of political turmoil. (U)

The low first quarter figure in part stems from a renewed emphasis on the quality of industrial output. The State Statistical Bureau supposedly will no longer allow factories to claim as output those products that fail to meet quality standards. (U) (Unclassified)